

Mr. Jack Eisenlauer

June 28, 1976

### Possessory Interests - Welfare Exemption

Because of a recent inquiry concerning the possible exemption of a possessory interest held by a qualified welfare claimant in public school property, the question of the propriety of exempting any possessory interest in government-owned property has arisen. The following comments are intended as a statement of the legal staff's position and as a guideline for disposition of such cases and others involving different owners and users. For purposes of this memo, it is assumed that when we are referring to property owned by a governmental entity, the property is exempt because of such ownership and that the claimant-user and the uses of the property satisfy all requirements of the welfare exemption statutes.

#### I. Property leased to a welfare claimant is exempt if:

- a) The lessor is a governmental entity which receives exemption on property it owns. A public school district as a political subdivision of the state is a trustee of property the beneficial ownership of which is in the state (43 Cal.Jur.2d pp. 494-497) and therefore exempt.
- b) The lessor is itself an organization qualified for the welfare exemption and its lease of the property is for an amount less than economic rent. In calculating economic rent, property taxes should be excluded. A lease of property for an amount equivalent to economic rent constitutes a nonexempt use by the owner.

#### II. Property leased to a welfare claimant is not exempt if:

- a) The lessor is a private citizen or corporation whose property is generally subject to tax.
- b) The lessor is an entity other than a governmental entity even though it is eligible for an exemption other than the welfare exemption on property it owns.

III. Property owned by a welfare claimant and leased to others is exempt if:

- a) The charge for use, no matter how denominated, is less than economic rent;
- b) The user is a qualified welfare organization or a governmental entity; and
- c) The use of the property is for exempt welfare purposes, i.e., the activity would be regarded as charitable, religious or hospital if engaged in by the owner-claimant.

Note: It is probable that the above described situations are not all inclusive. Please inform us of any others you are aware of and especially any which we have previously considered and determined that denial of exemption was required. We must be consistent.

It seems appropriate to make some comments concerning possessory interest that will, hopefully, make the proposed guidelines more meaningful.

Starting with the time-worn expression that the California Constitution mandates that all (private) property be taxed unless eligible for a specific exemption, it becomes obvious that we must identify the property subject to the mandate. Section 103 gives us the general definition, and Section 104 more specifically defines "real estate" or "real property" to include "The possession of, claim to, ownership of, or right to the possession of land."--i.e., a possessory interest. This interpretation has been adopted in such cases as Georgia Pacific Corporation v. County of Mendocino (1972) 340 F.Supp. 1061.

Having decided that a possessory interest is property for property tax purposes, the next step is to determine whether or not it is owned by the exemption claimant so as to satisfy the "owned and operated" requirement of Section 214. Although the word "owned" can obviously have different meanings depending on the context and purpose of a particular statute in which it is used, it generally includes a claim or interest in property though less than a fee and even the interest of a holder of an imperfect or incomplete title. Possession of property "...is treated as property, which may be purchased and sold and for recovery of which an action may be maintained." (40 Cal.Jur.2d pp. 236, 294) Unless it results in frustration of legislative intent, there is no reason for concluding other than that a person in possession is the owner of the possessory interest which is property for property tax purposes.

III. a) Modified by Christ the Good Shepherd Luthern Church of San Jose v. Matheson, 81 Cal.App. 3d 355. (1978)

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Obviously, the intent of the welfare exemption, as well as all exemptions, is to confer a benefit on those authorized to claim it. The reciprocal of that is the intent that those not qualified for some exemption not obtain indirectly what they are not entitled to obtain directly. Were we to approve exemption of a possessory interest in property for which the fee owner could claim no exemption, we would be clearly violating legislative intent. (Ohrbach's, Inc. v. County of Los Angeles (1961) 190 Cal.App.2d 575) Likewise, if we were to grant exemption to a possessory interest in property the fee to which is exempted under another statute intended to encourage the use of the property for a certain purpose and the existence of the possessory interest prevents fulfillment of that purpose, we would be in error. Such a result hardly seems possible when property owned by a governmental agency and devoted to public use is used by a welfare-exemption type organization whose purpose is also to provide a benefit to the public. It is our conclusion that considering a possessory interest as property owned by an exemption claimant and eligible for exemption does not frustrate legislative intent and should be exempted.

In conclusion, for purposes of emphasis, we do not believe that all possessory interest should be exempted. Only those qualifying as taxable possessory interests as defined in Board Rule 21(b) (Cal. Admin. Code) should be so treated. Questionable situations will be reviewed by Legal on your request.

JJD:mp

cc: Mr. W. Grommet  
Mr. V. Price  
Mr. Bill Minor  
Legal Section

Mr. John H. Knowles

July 27, 1976

Robert D. Milam

Welfare Exemption - Jim Delaney's Possessory Interest Memorandum  
of June 28, 1976

A couple of questions have arisen in my mind as to the applicability of the standards enumerated in Jim's memo of June 28, 1976. I would appreciate your review of the attached memo to Bill Grommet because some of it (although not the conclusion) seems to conflict with the memo.

The first problem is that of the taxable status of property leased to a welfare claimant. Jim's memo (II.B) says that the property is not exempt if the lessor is not a government entity even though it is eligible for an exemption other than the welfare exemption. If this is the position we have taken in the past, then it appears we may have been inconsistent. One of the inconsistencies concerns the status of personal property owned by a bank and leased to a welfare claimant. We have stated that the property is exempt whether owned by the bank or the welfare organization.

This problem seems to arise from the assumption that only government property is exempt simply because of ownership. However, it seems to me that bank personal property is in the same category in that it is exempt simply because it is owned by a bank. To the extent that non-government property is exempted because of ownership, we should reach the same conclusion as we have in the government-ownership cases. I do not see how property exempt in the hands of the owner and leased to a qualified welfare organization whose use of the property renders it exempt can become taxable. The reverse should also be true; a welfare organization leasing to an exempt entity for an exempt use.

A second problem is one that really does not fit neatly into the standards mentioned in the memo. When a redevelopment agency owns property and leases to a qualified welfare claimant, what tests do we use? It may be a government entity, but does not receive an exemption on property it owns. Test II.A of the memo also seems to exclude such an agency.

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To resolve these problems, I think the guidelines should state that if property is totally exempt in the hands of the owner, then it is still exempt when leased to a qualified welfare claimant and used for exempt purposes. The test should not be whether the lessor is a government agency, but whether the property is exempt in the hands of the owner, no matter who that is. Additionally, if a lessor is a taxable entity, even if it is an organ of government, the property should be taxable. To accomplish these changes, I suggest the following modifications of Jim's guidelines.

1. I.A. - The lessor receives exemption on property it owns.
2. II.A. - The leased property is generally subject to tax in the hands of the lessor.
3. II.B. - Eliminate.
4. III.B. - The user is exempt; and

RDM:el  
Attachment

cc Mr. J. J. Delaney  
Legal Section



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February 9, 1979

No. 79/30

TO COUNTY ASSESSORS:

WELFARE EXEMPTION

A recent decision by the California Appellate Court causes us to change our position concerning the granting of the welfare property tax exemption to property which is owned by one welfare exempt organization but leased to another welfare exempt organization. (See Christ the Good Shepherd Lutheran Church v. Mathiesen, (1978) 18 Cal. App. 3d 355.)

Prior to this court decision, we advised county assessors that a property owned by one exempt organization and leased to another exempt organization would be granted a welfare exemption provided:

"...the rent received by the lessor should not exceed the cost of making the property available, that is, utility, maintenance, and/or repair costs incurred because of the use of the property by the lessee. Otherwise the property would be considered used for profit-generating purposes in the hands of the lessor and, therefore, ineligible for exemption." (See p. 26 of Assessors Handbook 267, Welfare Exemption, revised December 1977.)

We advised that leases that included these operating costs plus depreciation based upon replacement, and principal and interest payments on the property exceeded the bounds of a qualified lease because it was profit generating. However, the court examined this administrative policy in the situation where one religious organization leased to another religious organization for a rental amount equal to or less than market rent. The court found:

"It was never the intent of the statute or the constitutional provision to prohibit an exempt organization from conducting activities which produce an income over and above operating expenses...." (Christ the Good Shepherd, supra, p. 363.)

and the court concluded:

"...the fact that rental income may exceed operating expenses in a given year will not disqualify a tax-exempt lessor from receiving the welfare exemption on real property leased to another exempt organization where the property is exclusively used for exempt purposes and such leasing arrangement is not intentionally profit-making or commercial in nature." (Christ the Good Shepherd, supra, p. 366.)

Therefore, whether such a lease agreement falls within qualifying bounds turns upon whether it is found "not intentionally profit-making or commercial in nature." The court did not provide any clear or precise test for use in making such determination, however. Thus, we suggest the following guides indicate a non-qualifying lease:

1. The property was acquired by the welfare exempt owner specifically for leasing to other welfare exempt organizations, rather than for its own use.
2. The rent charged is greater than 10 percent over and above all operating costs. Operating costs include the cost needed to make the property available, that is, utility, maintenance, and/or repair costs incurred because of the use of the property by the lessee, and an amount necessary to cover the expense of depreciation based on cost of replacement and amortization of, and interest on, indebtedness.

When presented with a lease situation then, we suggest you examine the lease, consider the above guides and others as appropriate, and reach a conclusion, as would a reasonable person, as to whether the lease would be nonqualifying by reason that it is "intentionally profit-making or commercial in nature." If you conclude that a lease is nonqualifying, please so indicate in B 1 f (fund-raising) on the Field Inspection Report and

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provide your calculation of the 10 percent income over expenses in F (Recommendation) on the report or on the reverse side of the report. Keep in mind that depreciation must be based on cost of replacement, not on book cost. Please also indicate in F (Recommendation) on the report any instance in which rent charged is \$1,000 or more per month.

Additionally, as a result of the court's decision, any property denied the welfare exemption in past years solely because it had been leased to another welfare exempt organization for an amount greater than the cost of making the property available may be granted exemption for those years provided:

1. A timely claim or claims for refund are filed.
2. Amended findings are requested.
3. The lease agreement is "not intentionally profit-making or commercial in nature", as discussed above.

In order for us to be able to issue amended findings (Been Met), you must provide us with amended field inspection reports, one for each year involved and each containing the lease terms pertaining to the premises and to the rental paid for the lease period, for example:

1. \$3,600 per year for week-day use of Church Sunday School Building; or
2. \$300 per month for exclusive use of second floor of Boys Club building.

Subsequent to our review, we will forward amended findings or otherwise communicate with you.

Please refer any inquiries or additional questions to Mr. William Grommet of our Assessment Standards Division, (916) 445-4982.

Sincerely,



Verne Walton, Chief  
Assessment Standards Division

VW:fr